No. 11959

IN THE

United States Circuit Court of Appeals

NINTH CIRCUIT

INDEPENDENCE LEAD MINES COMPANY, an Arizona Corporation,
Appellant,

vs.

ALMA R. KINGSBURY AND OLGA MARQUARDT,
Appellees.

Reply Brief

Upon Appeal from the District Court of the United States for the District of Idaho, Northern Division

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Appellees' brief is mindful of the quotation set out below, and employed by a member of the bar of this court many years ago, because it is a clear demonstration of the truth of Dryden's statement in the Prologue to "All For Love":

> "Errors like straws, upon the surface flow;
> He who would search for pearls, must dive below."

The emphasis in appellees' brief is carefully restricted in its consideration of this case to those parts of the controversy which the appellees detach from the entire narrative of the events alleged in appellant's amended petition, and construe most favorably to themselves, in disregard of the legal principles applicable to the whole. The method of argument is reminiscent of the undue emphasis many times placed upon a word, a phrase, or a paragraph, which has been separated from the meaning indicated by the whole context from which it is selected, for the purpose of lending substance to that method of argument.

In order that the court may be afforded a chronological reply to the brief of appellees, this brief will reply to the appellees' order of discussion set forth in their briefs.

I.

In the appellees' statement of the case there is indulged the presumption that appellant's statement of the case submits matters as appellees say "which were

adjudicated in the same case * * *'' (Appellees' Brief, page 1).

The appellees further say the failure by appellants to discuss the fact that F. C. Keane was only one of the lawyers for appellant and that there were two other counsel, namely, Chas. E. Horning and Eugene F. McCann, is a signal factor in the shroud of regularity which must be conceded to appellees' activities. In the first place appellant does not concede, and has never conceded, the regularity or legality *of any of the proceedings* leading up to the stipulated judgment whereby F. C. Keane, the defalcating president of the appellant, generously awarded the appellees all of the Clayton Silver Mines stock held by the appellant for the benefit of its assessable stockholders, without a contest of any kind, and in a collusive, conniving fashion. The appellant in this case has always contended that all of the fraud involved in this action was material and was not cut off by the collusive stipulated judgment; the appellant was not estopped by the stipulated collusive judgment between appellant and appellees. Appellant instituted its action for the express purpose of reopening and setting aside the collusive judgment, and has therefore made an issue of *the entire fraud perpetrated on the corporation* which culminated in the collusive judgment. That judgment, in fact, which was uncontested, was a complete ''sell-out'' by the appellant's officers to the appellees, who well knew all of the conditions that existed within the appellant corporation, and who took advantage of that knowledge to secure the judgment without any trial

of the issues which were involved. If the appellant corporation failed to make an issue of the sleight of hand stock manipulations, which led up to its motion or petition to reopen the judgment, it would be lax in its duty to the assessable stockholders. It seeks to recover not only the Clayton Silver Mines trustee stock, which appellees have taken unto themselves by virtue of the collusive judgment, but it also must, of necessity, eliminate the ever-present shadow of the domination by a million shares of non-assessable stock, claimed by the appellees, of the appellant corporation's affairs. This so-called common stock Class A, by virtue of the stipulated judgment secured by the appellees, will deprive the common assessable stockholders of their proper voice in the corporation's affairs and will further devalue their stock, as it already has done, because of its failure at any time to assume the necessary expenses of assessment by the appellant corporation; nor will it be liable for any financial assistance required by the appellant in the future. That stock, as we have shown, has been received by the appellees without any consideration whatsoever moving to the appellant corporation; this all in fraud of the representations previously made by the officers of the corporation, who were the husbands and predecessors in interest of the appellees. (Op. Brief Appellants, pages 35-42, inc.; Tr. pages 51-58, inc.) We believe the consideration of these facts is pertinent. In our opinion, the appellees' argument concerning the association of other counsel by F. C. Keane, the president of the appellant, at the time of the stipulated

judgment, requires no answer. F. C. Keane knew the position that he was in and it is unlikely that he would lay himself open by acting independently. We do not believe that in view of his activities, *which the record discloses he has never denied,* that he could clothe his activities, or the activities of the corporation at the time he was president, with an aura of respectability or regularity, by the association of Mr. Horning and Mr. McCann, the latter being the law partner of Mr. F. C. Keane.

II.

It is conceded that ordinarily fraud which was at issue, or which could have been dealt with in litigation concluded by a judgment, cannot be made the basis of an attack on the judgment. However, the facts in the case in issue indicate that the rule is inapplicable here. In the present instance, the fraud which *should have been made an issue* (Tr. pages 39-41, inc.), could not be, and was not dealt with in the proceedings leading up to the collusive judgment, because the collusion between the president of the appellant corporation and appellees, *prevented its litigation.* The effect, of course, was that the fraud was not litigated. The fact remains plain, that there has been no real contest, or contests of any kind in this matter, and there is thus no merit in the contention of appellees, that the collusive judgment is now *res adjudicata.*

> "Where the unsuccessful party has been prevented from exhibiting fully his case, by fraud or

> deception practiced on him by his opponent, as by keeping him away from court, a false promise of a compromise; or where the defendant never had knowledge of the suit, being kept in ignorance by the acts of the plaintiff; or where an attorney fraudulently or without authority assumes to represent a party and connives at his defeat; *or where the attorney regularly employed corruptly sells out his Client's interest to the other side*—these, and similar cases which show that there has never been a real contest in the trial or hearing of the case, are reasons for which a new suit may be sustained to set aside and annul the former judgment or decree, and open the case for a new and fair hearing." *United States vs. Throckmorton,* 98 U. S. 61, 25 L. Ed. 93, page 95. (Emphasis supplied.)

Neither of the cases cited by appellees (pages 8 and 9, Appellees' Brief), to-wit, *Toledo Co. vs. Computing Co.* and *Brady vs. Beams,* is on all fours with the issues before this court. In the *Brady vs. Beams* case the facts clearly indicate that the fraud alleged had been discovered *before the judgment, and not after, and that case is therefore not in point.* However, it might be observed that *the fraud in this case was certainly known and discovered and actively aided by the appellees before they entered into the stipulated judgment with the appellant.* As early as July, 1945, the appellees, well knowing what Mr. Keane, the president of appellant corporation, was doing in the way of dissipating the trust stock owned by the appellant, caused notice to be given to the Clayton Silver Mines Company, in writing, to stop the transfers of Clayton stock and threatened an injunction to enforce the

notice. (Op. Brief Appellants, pages 48, 49; Tr. pages 72, 73.) The *Toledo Co. vs. Computing Co.* case is likewise not in point with the present case. In that case the court held *that there was an absence of due diligence.* No contention is made by appellees against appellant's petition on that ground.

III.

Appellees argue the position that appellant is not entitled to any relief against the collusive judgment attacked by the appellant, because appellees have not participated in fraud or connived in the procurement of the judgment. We submit that appellees have in fact connived to procure the judgment, and furthermore, that their fraud and connivance by reason of their knowledge and succession in interest, extends all the way back to the point where their husbands who controlled the appellant corporation took to themselves, fraudulently, and without consideration, the entire one million shares of common stock Class A. The appellees have derived thereby the benefits of all of the remaining trust fund shares of the Clayton Silver Mines stock owned by the appellant corporation. Appellees should not now be allowed, in equity and fairness, to separate themselves in any sense from the continuing scheme, and the continuing fraud, practiced upon the appellant corporation. The million shares of common stock Class A has been, was, and now is, a fraudulent issue. Its circumstantial change of ownership is attended by all of the deficiencies which attached to it from the very time it was surreptitiously

taken from the corporation without any consideration, and in contravention of express representations made to the stockholders. (Tr. page 52.)

Furthermore, these appellees have had knowledge at all times of the character of the common stock Class A. They have been in a position to know the character of that stock. They have known of the defalcations of the president of the appellant corporation. They knew of the defalcations and they actively sought to prevent any further transfers of the stock, not for the purpose of aiding or assisting the appellant corporation, or for the purpose of keeping the appellant corporation a liquid operating entity, but for the purpose of securing to themselves the entire corporate holdings of the trust fund stock. The appellees likewise negotiated surreptitiously with the emissary of the president, of the appellant corporation, one John Sekulic. In view of these circumstances, it is impossible to construe these facts favorably to the position taken by the appellees, and it really is a strain on credulity to gratuitously assume, as appellees do, that they have not participated or connived at fraud within the meaning of the term. Appellees take the position that because they did not originally instigate a continuing fraud, they could in no wise be charged with it, regardless of their obvious collusion and connivance. Such a conclusion is not sustained in the law. Webster defines connivance to mean:

> "to shut the eyes; to feign ignorance; to pretend not to look; to cooperate secretly, or to have a secret understanding."

The appellees had actual notice of the frauds involved and they participated in them. They did not take the proper action, which certain stockholders of the corporation took, when those stockholders dug out the facts of the defalcation of the president of the appellant corporation; they did not institute an action for receivership for the benefit of the corporation and its stockholders (Tr. pages 82-101, inc.); and yet, as the amended petition seeking to reopen the judgment alleges, they knew the facts which were set up in the complaint for receivership relating to the defalcations of F. C. Keane, the president of the appellant corporation. We submit that the facts in issue before this court are supported in every way by the case submitted in appellant's opening brief, to-wit, *Whitney vs. Hazzard,* 18 S. D. 490, 101 N. W. 346. (See Op. Brief, pages 26, 27, 28; Appellees' Brief, page 14).

IV.

Appellees' discussion under their Title III shows the plucking by them of statements from the context of an authoritative work on corporations, which are not the rules applicable to the situation presented in this case. For instance, the statement of appellees (Appellees' Brief, page 19) that, "a stockholder is not bound to the strict rule as to knowledge of the affairs of a corporation that applies to directors and officers," is obviously incomplete. The petition to reopen the cause alleges, and the motion to dismiss of the appellees admits, *that the appellees actually did have knowledge of the affairs of the corporation.* There

certainly did not exist, at the time of the declaration by the appellant corporation of its stock dividend to its non-assessable stockholders, any community of interest with appellees. No community of interest existed which could be put at an end by the dividend resolution of the appellant. Appellees apparently assume that the stipulated collusive judgment, which impressed the common stock Class A with legality, now acts retroactively to sustain their argument that a community of interest existed between appellees and appellant, which ended with the refusal of the appellant to distribute dividend stock to the appellees, who were never legally entitled to it. The tenuous argument advanced by appellees, is analogous to a situation where an alleged creditor of a corporation in a spurious legal action connives with the president of the corporation to secure a stipulated judgment and pecuniary benefits to the alleged creditor, though the alleged creditor had no cause of action. Furthermore, the argument of appellees seeking to prove that they did not have a dominating "control" of the appellant in the sense alleged by the appellant, is quite without substance. The assertion of appellees that they had only twenty-five per cent of the stock in the appellant corporation is not the fair picture. As the appellant alleged in its amended petition to reopen, the truth of the matter is, "that the said plaintiffs prior to and during the litigation herein have claimed to be by many times the largest stockholders of the Independence Lead Mines Company * * *." (Tr. P. 71.)

The appellant should be allowed to go to trial on the merits, to prove the correctness of this allegation, because the appellees by their motion to dismiss have already admitted the same. Furthermore, the claim made in respect to appellees' ownership of only twenty-five per cent of the stock is quite unfair in view of the fact that there is no statement in connection therewith that appellees did not own, at the time of this controversy, any other shares of the appellant's stock in addition to the common stock Class A. Appellees cannot make the positive statement that they did not own a sizable block of stock of the corporation, in addition to the common stock Class A, at the time of the original litigation in this case. Of course, all through appellees' argument we find the matter of "control" confined to stock ownership alone, and no consideration is given by appellees to other factors involved in "control." No mention is made of the relation of the predecessors in interest of appellees to the corporation, who were in control of the appellant as its officers during most of the corporate existence, and who put the wheels in motion for the fraud and continuing fraud, which was joined by appellees, in their collaboration and participation.

Appellees contend, rather weakly, that the activities of John Sekulic on behalf of F. C. Keane constituted coercion, rather than collusion and connivance with appellees. Obviously, the appellees were not coerced in July of 1945 when they threatened to enjoin the Clayton Silver Mines Company from transferring any

more of the stock which F. C. Keane, the defalcating president of the appellant corporation, was selling for his own use and benefit. Furthermore, it is almost axiomatic, that a case for equitable relief against a judgment exists in a situation where the judgment is entered for the purpose of defrauding third persons; and it is certainly known that this rule prevails where a judgment creditor and a judgment debtor conspire or collude to defraud the creditors of the latter. In this case, at the time of the entry of the collusive stipulated judgment, it had not been judicially determined that the appellant corporation had deteriorated in financial status to the position that it was almost bankrupt; but it was a fact, known by the appellees, that there were serious financial disabilities in the appellant corporation.

Cases are legion in which a creditor and debtor settle claims to their own advantage in attempts to defraud third parties, who have equal claims, and the bankruptcy law itself recognizes the possibility of attempts being made by the bankrupt to prefer a creditor or class of creditors. Therefore, prohibitions against such acts are written into that law. Likewise it is hard for us to conceive that the appellees, or their able counsel, could have been in any way coerced by Mr. Keane or Mr. Sekulic. It would appear from the appellees' amended complaint (see Op. Brief, page 29; Tr. pages 44, 45), and the stipulated judgment, that appellees were "willingly" coerced, and substantially rewarded, in the cause against appellant corporation.

V.

Appellees' remaining argument is directed principally to the proposition that Keane and other officers of the appellant corporation were at least *de facto* officers, and the appellees in support of that proposition state at page 34 of their brief:

> "Of course, the allegations of conclusions of law, e. g., that Keane and the other officers 'had no right or authority to act as such directors or officers' (R. 66), are not admitted by the motion to dismiss."

Appellees, in posing their argument as above, have sought to build a straw-man and then to knock it down. We might add that paragraph VII (Tr. pages 70, 71; Op. Brief, pages 46, 47) states as follows:

> *"And the said plaintiffs, well knowing that no stockholders' meeting of the stockholders of said defendant Company had been held for a period of eight* (8) *years, and well knowing that there was no legally elected Board of Directors existing and that said so-called Board was illegal, dealt with said F. C. Keane in making said settlement, well knowing at the time that any action taken by said Keane was illegal and void."* (Emphasis supplied.)

This allegation is not a conclusion of law. It is a statement that the appellees had knowledge of all of those things set forth and alleged in the preceding paragraph, to-wit, paragraph VI of the petition to reopen. Appellees pointedly avoid any reference to this part of the petition. An examination of the cases

cited in support of appellees' *de facto* argument lends no support to appellees' argument (Brief of Appellees, pages 31, 32):

a. (Copper Belle Mining Co. case)—In this case the facts indicate that the directors had been elected by the stockholders without objection and were therefore *de facto* stockholders.

b. (Guaranty Loan Co. case)—This case held that the officers were *de facto* officers even though the election of the board may have been invalidated for lack of proper notice.

c. (Consumer's Salt Co. case)—This case held that though there was a dispute over the right of a majority of stockholders to vote, nevertheless the directors when elected became *de facto* directors.

d. (Farbstein case)—This case held that the validity of the board of directors could not be questioned in a case involving a challenge to a stock assessment.

e. (American Concrete Units Co. case)—This case held that even though the directors had not been re-elected at the meeting, yet they had been requested to continue to act as directors by the corporation.

f. (McKeehan case)—This case is authority for the statement that a non-stockholder could be a *de facto* director where he was elected.

The further argument of appellees, in support of the proposition that the appellant corporation can not repudiate its agreements or stipulations, *is not grounded on a situation where fraud and collusion are patent*

throughout the entire proceedings leading up to a stipulated judgment. The appellees here have engaged in connivance and collusion *to effectuate profitably,* the plan, connivance, collusion and fraud, of their predecessors in interest. Appellees' whole argument throughout the brief is bottomed on the gratuitous premise, that there was not a continuing fraud throughout, and in our opinion their brief, being wrongly premised, is unsupported by the law applicable.

The case likewise suggested by appellees, and claimed by them to bear directly on the situation involved in this appeal, to wit, *Piccard vs. Sperry Corporation* (see Appellees' Brief, pages 36, 37), is not in point as to fact or to law. In that case the issues were made in a challenge by a stockholder of the corporation against the corporation on two grounds. *It suffices to say that neither of the grounds complained of in the action referred to consisted of fraud.* One of the challenges was made on the bona fides of a settlement. The court said in that case:

> "This alone fails them, however, for I find the transaction was attended on the part of the directors by *good faith, sound business judgment and prudent solicitude for the welfare of the corporation.*" (Emphasis supplied.)

Applying the language above, in relation to the allegations of the petition to reopen, *it cannot be said that the determining factors of the bona fides in this dispute are in any way, shape or form comparable to those emphasized above.* There was in this case *no*

good faith, no sound business judgment, and no prudent solicitude for the welfare of the corporation on behalf of either appellees, acting with knowledge that F. C. Keane was not competent legally to stipulate a judgment, or F. C. Keane acting without any authority whatsoever.

CONCLUSION

1. The amended petition contains direct and undenied allegations of connivance and fraud, practiced by appellees and their predecessors, and the petition alleges an active participation and connivance in a fraudulent judgment secured by the appellees for their own exclusive benefit. There is present, fraud, and a suppression and exclusion of the equitable rights of the appellant and its assessable stockholders.

2. At this stage in the proceedings there is nothing before the court to justify the gratuitous statement that the compromise settlement was favorable to the appellant or was as favorable to the appellant as it was to the appellees.

3. The allegations of the petition eliminate any consideration of appellees' argument that they dealt with any *de jure* or *de facto* directors of appellant corporation. It is in fact affirmatively alleged in the amended petition, that the plaintiffs knew that F. C. Keane and the officers of the company were not legal officers, and could not act in accordance with law on behalf of the corporation in any dealings with ap-

pellees. True, the directors could have been *de facto* directors in dealings with other persons or stockholders, if those persons or stockholders had no knowledge that Keane and the directors were not legal directors. That situation is not present here.

4. The president of appellant corporation, F. C. Keane, acted illegally and dissipated practically all of the corporate assets. His actions were in disregard of the rights of assessable stockholders, who have for many years paid assessments on their stock through good times and bad, to keep the appellant corporation in business. F. C. Keane acted illegally as appellant corporation's president, and while so acting, he sought to protect and save himself by resort to a collusive stipulated judgment and fraudulent compromise.

5. Appellees here dealt with Keane as a director and an officer of the corporation, knowing full well that he was legally incapable of acting in such capacity, and they dealt with him directly and through his emissary, as the attorney for the appellant corporation, with knowledge of his activities as set forth above. They were knowingly parties to a collusive stipulated judgment and fraudulent compromise, and they actively participated and connived with Keane in his dual capacity as the attorney for the appellant corporation protecting Keane, and as Keane the defalcating officer. The appellees have actively lent aid and sustenance to Keane, and have deliberately, and with knowledge of the facts, helped themselves to the remaining assets of the trust stock of the appellant

corporation. Appellees well knew, that by so doing, they were depriving all other stockholders of any participation in the stock dividend of the appellant declared to them. The judgment of the District Court should be reversed.

Respectfully submitted,

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